SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

A8225-2

Securities Industry Association
120 Broadway
New York, New York 10271

Phone (212) 608-1500

Annual Subscription
$50.00 member • $48.00 non-member
$60.00 subscribers outside U.S. and Canada

Volume VIII, No.1 February 6, 1985

Foreign Activity in U.S. Securities

"Highlights"

1. In the third quarter of 1984, foreign investors escalated their net sales of U.S. equities to $1.6 billion from $473 million in the second quarter. Thus, through the first three quarters of 1984, foreigners were net sellers of $1.5 billion of U.S. equities. This compares with foreign net purchases of $4.9 billion for the first three quarters of 1983.

2. Foreign investors stepped up gross transactions in U.S. equities by 8% to $30.9 billion from the second to third quarter. Nevertheless, at $94.5 billion, activity through September ran 7% below the 1983 level for the same period.

3. Foreign net purchases of corporate bonds rose to $2.3 billion in the third quarter from $67 million in the second. The jump, however, reflects in part the new direct Euro-issues, which previously had not been captured in the Treasury's corporate bond flows.

4. Foreign investors made net purchases of $2.1 billion of U.S. Treasuries in the third quarter, bringing estimated total foreign holdings to $97.1 billion.

5. After making net sales of $360 million of foreign stocks in the first half of 1984, U.S. investors reversed their investment posture and were net buyers of $729 million in the third quarter. While U.S. investors took a more optimistic approach to investment in stocks of European and Canadian companies, much of the renewed interest was directed to Asian companies.

Introduction

In the recently published Delphi study of the securities industry in the late 1980s, participants indicated that the four most important factors influencing foreign investment in U.S. assets are: high real interest rates, political stability, a strong dollar and a favorable economic outlook.1/ In the third quarter of 1984, the dollar faltered only in August in an otherwise steady rise against all major currencies while the stock market also managed to show some steam. However, other factors pointed to a questionable outlook for foreign investment in U.S. equities. Thus, foreign investors accelerated net sales of U.S. equities to $1.6 billion in the third quarter from $473 million in the previous quarter.

The spurt in interest rates in June coupled with robust economic growth heightened investors' concerns over inflationary pressures. Indications during the third quarter that the rapid growth pace of the U.S. economy was slowing did not soothe investors' fears. Indeed, third-quarter real GNP expanded at a modest 1.6% annual rate. In addition, interest rates dropped from their lofty June peaks. Nevertheless, the uncertainty that marked the economic picture prompted foreign investors to make substantial net sales of U.S. equities.

The dollar continued on an upward path over the third-quarter. While most major currencies managed to appreciate vis-a-vis the dollar in August, these gains were negated by the dollar's strong strides in September. On a quarterly basis, the German mark suffered the sharpest depreciation against the dollar, 9.1%, followed by the pound, 8.6%. The Swiss franc depreciated by 7.9%, while the yen and French franc fell between 4% and 5% via-a-vis the dollar. In contrast, the Canadian dollar held fairly steady over the period.

Even the August rebound in an almost year-long slide was not enough to entice foreign investors back into the U.S. equities market. The August market pickup, largely maintained in September, put the market indices at an upward quarterly change for the first time in 1984. The NYSE and S&P 500 indices gained over 8%, respectively, while the Dow Jones Industrial Average increased by almost 7%.

1/ Keys to a Changing Securities World, Securities Industry Association and Arthur Andersen & Co., February, 1985.

Foreign and Institutional Participation in U.S. Equities

The participation of foreign investors in the U.S. equities market as a percentage of net inflows of institutions and foreigners peaked in 1975. Nevertheless, foreign investors have played a significant role in the equities market in the 1980s, with net purchases averaging $5.1 billion annually in the 1980-83 period. The marked increase in net purchases by private pension funds and state and local retirement systems in 1983 distinctly overshadowed foreign participation. Nevertheless, foreign buying of U.S. equities has been an important source of strenghth to the equity prices, trailing only private pension funds and state/local retirement systems in the accumulation of equities. With net selling in 1984, both pension funds and foreign investors took away an important cushion for equity prices.

TABLE I

FOREIGN PARTICIPATION COMPARED TO INSTITUTIONAL PARTICIPATION IN U.S. EQUITIES
($ millions)

Net Purchases by:	1970	1975	1980	1981	1983	9 mos. to 9/30/84
Private Pension Funds	$ 4,585	$ 5,714	$11,704	$ 7,325	$15,416	$ (6,141)
Mutual Funds	1,225	(1,195)	(1,814)	(571)	622	5,635
Life Insurance Co.	1,795	1,152	315	1,542	4,489	754
Property-Liability Insurance Co.	890	(1,003)	3,153	1,632	2,944	1,535
State and Local Retirement Systems*	2,137	2,048	5,951	8,353	18,865	3,976
Foreign Investors	626	4,672	5,427	5,830	5,423	(1,482)
Total Net Inflows	11,258	11,388	24,736	24,111	47,759	4,277
Percent of Foreign Participation	5.6%	41.0%	21.9%	24.2%	11.4%	--

SOURCES: U.S. Department of Commerce, U.S. Treasury and Federal Reserve.
*Book Value

Foreign Activity in U.S. Equities

Gross Activity

Foreign investors stepped up gross transactions in U.S. equities by 8% in the third quarter to $30.7 billion from $28.7 billion. The bulk of the stepped up activity stemmed from Asia, as transactions were accelerated by 20% to $4.7 billion from $3.9 billion in the second quarter. European investors increased activity by 5% and Canadians, by 8%. Despite the third-quarter pickup, 1984 activity at the end of September ran 7% below the 1983 level of $102.2 billion for the same period.

Net Purchases

Not only did foreign investors maintain the net selling posture of the second quarter, but net sales of U.S. equities were escalated over threefold in the third quarter to $1.7 billion. Thus, foreign investors have been net sellers of $1.5 billion of U.S. equities through the first three quarters of 1984, a highly unusual development for these investors. Although Canadian investors increased net purchases to $466 million and Latin American and Caribbean investors remained net purchasers, this activity did not offset the large sales stemming from Europe. The pace of net selling by European investors was stepped up from $390 million in the second quarter to $1.7 billion in the third. Asian investors also contributed to the net divestiture position of foreign investors in the third quarter, increasing net sales by 73% to $743 million.

TABLE II

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1984 Second Quarter		1984 Third Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$15,952	$(390)	$16,761	$(1,731)
Belgium-Luxembourg	568	0	690	(40)
France	1,362	134	1,240	(140)
Germany	1,119	(81)	1,689	(227)
Netherlands	1,009	(137)	865	(131)
Switzerland	4,906	(250)	4,762	(1,014)
United Kingdom	6,458	(138)	6,929	(139)
Canada	4,034	170	4,356	466
Latin America & Caribbean	4,432	144	4,293	165
Bermuda	1,376	4	1,645	45
Netherlands Antilles	2,039	153	1,575	131
Asia	3,900	(430)	4,661	(743)
Hong Kong	551	(69)	826	(258)
Japan	433	1	791	(37)
"Other Asia"*	2,439	(441)	2,739	(477)
Total All Countries	$28,693	$(473)	$30,860	$(1,564)

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

European Investors

In the third quarter, European investors made massive sales of U.S. equities, $1.7 billion, compared with $390 million in the second quarter. Although net sales were reported by all major European countries, the large net sales of $1.0 billion by Swiss investors accounted for almost 60% of the quarterly figure. German investors also increased net sales of U.S. equities, from $81 million in the second quarter to $227 million in the third. Activity stemming from the Netherlands and U.K. remained at the same level on a quarterly basis, net sales of around $130 million. French investors, the only major European net purchasers of U.S. equities in the second quarter, swung to net sellers of $140 million in the third.

U.S. equities fell into disfavor with German investors in the second quarter, and this investment posture persisted through the third quarter. German investors escalated net sales to $227 million in the third quarter from $81 million. Although growth forecasts for the German economy were reduced after settlement of the metalworkers' strike in June, German investors evidently were more interested in domestic and other investment prospects than in U.S. equity investment. Confidence in domestic investment would have been well rewarded as the Frankfurt exchange, after a sharp dip at the beginning of the third quarter, climbed steadily to peak on December 1. Benefiting in part from the reversal of a two-year long net capital outflow, the German stock exchanges reportedly enjoyed a good year in 1984, with investors lured back into stocks from fixed income securities by the promise of higher returns based on increased corporate earnings, rock-bottom inflation and declining interest rates.2/

During the first nine months of 1984, U.K. investors were consistent net sellers of U.S. equities, averaging around $130 million quarterly. The pound suffered a particularly sharp depreciation, 8.6%, against the dollar during the third quarter, driven down by plentiful oil supplies and domestic labor disputes. To prop up the tumbling pound, the Bank of England reluctantly boosted interest rates. Although the rate increase was temporary, it exacerbated concerns over the underlying strength of the British economy and unacceptably high unemployment. Thus, given a questionable outlook for equity investment in the U.S. and U.K., British investors sought fixed income returns. U.K. investors showed considerable interest in U.S. corporate and Treasury bonds in the third quarter. (Elimination of the foreign withholding tax on interest was helpful.)

2/"World's Stock Exchanges Experience a Difficult Year," The New York Times, 12/31/84

Swiss investors made substantial divestitures of U.S. equities in the third quarter. Net sales of $1.0 billion were made, compared with $250 million in the second quarter . On the other hand, French investors reversed their investment posture from net purchasers of $134 million in the second quarter to net sellers of $140 million in the third. During the third quarter, there was anticipation that the French government would ease the foreign exchange premium mechanism that imposes a punitive exchange rate on those buying foreign securities.3/ Nevertheless, although some French investors may have adopted a wait-and-see approach, others were quick to join most European investors in making net divestitures of U.S. equities.

Canadian Investors

Through the third quarter, Canadian investors maintained their position as the largest foreign purchasers of U.S. equities in 1984. After a dip in net purchases to $170 million in the second quarter, net purchases rose to $466 million in the third, bringing total net purchases by Canadian investors to $1.3 billion for the first nine months of 1984. Although the outcomes were expected, the change in Canadian leadership in June and the upcoming September national elections set off public debate on interest and exchange rate policy. Thus, given an uncertain policy atmosphere and a languishing domestic stock market, Canadian investors increased investment in U.S. equities.

Asian Investors

Asian investors escalated net sales of U.S. equities by 73% to $743 million in the third quarter from $430 million. Large net sales, $258 million, from Hong Kong accounted for the bulk of this amount. Net sales by the oil-exporting countries in the third quarter were on par with those in the second, averaging about $460 million quarterly. Saudi Arabia alone was reportedly forced to draw down some $10 billion in reserves in the 1983-84 financial year.4/ With oil production and revenues at depressed levels and a $13 billion deficit projected for the current fiscal year, it is likely that the oil-exporting countries will continue to make net divestitures of U.S.-dollar denominated assets, which represent the main component of their foreign reserve assets.

3/"Paris likely to ease foreign exchange curb," Financial Times, 10/26/84.

4/"Oil producers begin to draw on investments," Arab Banking, Financial Times Survey, 10/15/84.

Foreign Activity in U.S. Corporate Bonds

Foreign net purchases of corporate bonds escalated from $67 million in the second quarter to $2.3 billion in the third. The jump, however, reflects in part the incorporation of new direct Euro-issues into Treasury's corporate bond flows. Therefore, due to this accounting change, foreign activity in corporate bonds is not strictly comparable on a quarter-to-quarter basis. While net purchases were reported for most major countries, the large purchases of $1.3 billion by U.K. investors accounted for most of the total third-quarter figure.

Net purchases by European investors rose from $291 million to $1.8 billion in the third quarter, with U.K. investors fueling the increased activity. U.K. investors showed considerable interest in both corporate bonds and U.S. Treasuries in the third quarter. U.S. corporate bond yields peaked in June at 14.50% and gradually declined to 12.88% by the end of September.[5/] While U.K. rates spurted from June to July, U.S. rates were some 100 basis points higher than U.K. rates through much of the third quarter.

TABLE III

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1984 Second Quarter		1984 Third Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$1,981	$291	$4,634	$1,814
Belgium-Luxembourg	126	(48)	124	12
Germany	666	292	1,158	374
Switzerland	286	14	393	39
United Kingdom	682	(8)	2,636	1,316
Asia	1,375	(293)	1,472	386
Japan	275	131	569	223
"Other Asia"	919	(439)	732	74
Total All Countries	$4,117	$67	$6,942	$2,310

Source: U.S. Treasury

5/ Interest rate analysis in this report is based on data provided in World Financial Markets, Morgan Guaranty Trust Company.

Similar to U.K. investors, other European investors made net purchases of Treasuries. German investors increased net purchases 28% to $374 million, and Swiss investors escalated net purchases to $39 million from $14 million. Investors located in the Belgium - Luxembourg countries swung from net sellers of $48 million to net purchasers of $12 million.

In the third quarter, Asian investors reversed their position to net purchasers of $386 million of corporate bonds from net sellers of $293 million. The reversal in investment posture is based largely on the cessation of net selling by the oil-exporting countries. In a departure from recent investment patterns, the oil-exporting countries purchased $74 million of corporate bonds, in contrast to net sales of $439 million in the second quarter. Japanese investors, who purchased $284 million of corporate bonds in the first half of 1984, stepped up net purchases to $223 million in the third quarter.

Foreign Activity in U.S. Treasury Notes & Bonds

In the third quarter, foreign net purchases of U.S. Treasuries dipped to $2.1 billion from $3.1 billion in the second quarter. However, in the second quarter, the large net purchases of international organizations (not shown in Table IV) accounted for the bulk of the total figure. So too, in the third quarter, large net sales of $3.0 billion by these organizations considerably offset the net purchases made by other foreign investors. Foreign holdings of U.S. Treasuries are estimated at $97.1 billion at the end of September.

European net purchases of U.S. Treasuries soared to $4.4 billion from $1.5 billion. Net purchases by U.K. investors jumped from $785 million in the second quarter to $2.8 billion. Other European countries evidenced a marked pickup of interest in U.S. Treasury investment. In contrast to prior quarters, when some 90% of European activity in Treasuries originated in the three major countries shown in Table IV, about 21% resulted from other countries in the third-quarter. For example, $184 million was purchased by Austrian investors, $157 million by French investors, and $418 million by the Treasury category "Other Europe."

Investors from Japan and the oil-exporting countries moderated their investment approach to Treasuries in the third quarter. Net purchases by Japanese investors dropped 14% to a still-substantial $885 million from $1.0 billion. Nevertheless, through the first three quarters of 1984, much of the reported large Japanese capital outflow has been invested in Treasuries, with net purchases of $2.3 billion made. In contrast, investors from the oil-exporting countries made net divestitures of $867 million in the third quarter, compared with $1.6 billion in the second.

TABLE IV

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1984 Second Quarter		1984 Third Quarter	
	Net Purchases	Estimated Holdings	Net Purchases	Estimated Holdings
Europe	$1,463	$38,739	$4,360	43,099
Switzerland	72	1,324	436	1,760
West Germany	760	19,596	180	19,776
United Kingdom	785	9,212	2,787	11,999
Asia	(279)	45,558	89	45,647
Japan	1,027	15,360	885	16,245
"Other Asia"*	(1,646)	26,493	(867)	25,626
Total All Countries	$3,143	$95,001	$2,075	97,076

Source: U.S. Treasury

* Treasury has discountinued publication of the estimated holdings of the oil-exporting countries. Figures based on last published figure plus summation of quarterly data.

U.S. Investor Activity in Foreign Stocks

After making net sales of $360 million of foreign stocks in the first half of 1984, U.S. investors reversed their investment posture and made net purchases of $729 million in the third quarter. While U.S. investors took a more optimistic approach to investment in stocks of European and Canadian companies, much of the quarterly figure stemmed from renewed interest in Asian companies. Unlike the U.S. stock market, major stock markiets in some foreign countries embarked on a stready upward path over the second half of 1984. We continue to believe that the Treasury numbers, while indicative of the trend of U.S. investment in foreign stocks, do not necessarily reflect the full magnitude of that investment.

U.S. investors stepped up net purchases of stocks of European companies to $337 million in the third quarter from $101 million in the second. Interest in European stocks was widespread, with net purchases made in all major countries. Accounting for much of the increased third-quarter figure was the swing from net sellers to net purchasers of $82 million and $46 million of stocks of companies located in the Netherlands and Switzerland, respectively. Moreover, U.S. investors

boosted net purchases of French stocks by 42% to $34 million from $24 million. Net purchases of U.K. stocks were increased by 10% to $99 million.

U.S. investors' massive sales of Japanese stocks, $423 million in the first half of 1984, dwindled to a moderate $50 million in the third quarter. While the Japanese stock market recovered somewhat from its steep second-quarter plunge, U.S. investors adopted a wait-and-see approach, possibly assessing the implications of the liberalization of Japan's financial market. However, net purchases of $234 million of stocks of Hong Kong companies, not shown in Table V, are largely reflected in the Asian figure. The volatile Hong Kong index registered a swift drop from April to mid-July as negotiations on the Colony's future bogged down. However, given the settlement of some political uncertainties and a reasonably good economic outlook, U.S. investors took part in the market rally of the second half of 1984.6/

TABLE V

GROSS ACTIVITY AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1984 Second Quarter		1984 Third Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$3,055	$101	$3,093	$337
France	258	24	186	34
Netherlands	264	(42)	290	82
Switzerland	237	(5)	266	46
United Kingdom	1,864	90	1,961	99
Canada	1,045	(17)	1,088	44
Asia	2,289	(267)	2,250	246
Japan	2,014	(230)	1,692	(50)
Other	621	177	414	102
Total All Countries	$7,010	$(6)	$6,845	$729

Source: U.S. Treasury

Carolyn Hildebrandt
Assistant Vice President

6/"Asian Investors Wary of U.S. Economy," The Wall Street Journal, 1/2/85